

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:4 – PLR-109935-01

Date:

December 16, 2008

Re:

Legend

A =
Trust =

Partnership =
General Partner A =
Date 1 =
Date 2 =
Agreement =
Collateral Assignment =

Policy =

Dear :

This is in response to your December 5, 2008 letter and prior correspondence, submitted by your authorized representatives in which you requested rulings concerning the federal income, estate and gift tax consequences of the ownership by a trust of a life insurance policy subject to a split-dollar life insurance agreement.

On Date 1, A established an irrevocable trust, Trust, for the benefit of his issue. During A's life, the Trustees are authorized to distribute some or all of the trust income or principal for the education, health, maintenance and support of A's issue. After the death of A, Trust is to be divided into separate shares with a separate share to be held

for each living and deceased child of A survived by issue. The separate shares will be held in trust for the designated beneficiaries. The Trustees of Trust are two unrelated parties.

On Date 2, which precedes 2002, Trust purchased Policy, a life insurance policy on the life of A. The Trust was designated owner and beneficiary of Policy.

Also on Date 2, Trust entered into a split-dollar life insurance agreement (Agreement) and collateral assignment (Collateral Assignment) with Partnership. Partnership is a limited liability limited partnership with two general partners, including General Partner A, a corporation of which A is the sole shareholder. Under the Agreement, Trust is designated the owner of the policy. The owner may exercise all rights of ownership except the right of the collateral assignee as described below.

Under the Agreement, Partnership will pay all of the policy premiums and Trust is obligated to repay Partnership that portion of the annual premiums equal to the lesser of: (1) the applicable amount provided in the P.S. 58 tables set forth in Rev. Rul. 55-747, 1955-2 C.B. 228 (or the tables and rates as may be in use under applicable treasury regulations for the date on which the determination is made); or (2) the insurance carrier's rate for one-year renewable term insurance. Upon the death of A, the Agreement terminates and Partnership is to receive a portion of the proceeds of the policy equal the greater of premiums paid (less any Partnership loans against the policy) or cash surrender value (reduced by any Partnership loans against the policy). Trust is designated beneficiary of the balance of the insurance proceeds.

Prior to the death of A, the Agreement may be terminated unilaterally by Partnership or the Trustees. The Agreement will also terminate upon the dissolution or bankruptcy of Partnership. Within 30 days of termination, Trust is to pay Partnership the cash value of the Policy (reduced by any Partnership loans against the policy).

To secure Partnership's interest in the policy and its proceeds, the Trustees executed Collateral Assignment pursuant to which the Trustees assigned the policy to Partnership. However, under the terms of the Collateral Assignment, the Trustees specifically retain all rights of ownership in the policy subject to the right of Partnership to borrow against its share of cash value. The rights expressly retained by the Trustees include, but are not limited to: the right to cancel or surrender the policy, the right to assign ownership of the policy, the right to designate and change the beneficiary of the policy, the right to obtain loans on the policy, and the right to exercise all settlement options permitted by the terms of the policy.

It is further represented that Agreement has not been modified in any manner since Date 2, and that A will dispose of his interest in General Partner A.

You have asked for the following rulings: (1) that the payment of the premiums by Trust and Partnership pursuant to the Agreement are not income to, or gifts by A; and (2) that any proceeds of the policy payable to the Trust will not be included in the gross estate of A under section 2042(2).

Ruling Request 1

Section 61 provides, in general, that gross income means all income from whatever source derived.

Section 2501 imposes a tax on the transfer of property by gift by an individual. Section 2511 provides that the tax imposed by § 2501 shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible. Section 2512(b) provides that, where property is transferred for less than adequate and full consideration in money or money's worth, the amount by which the value of the property exceeds the value of the consideration is deemed a gift.

Section 25.2511-2(b) of the Gift Tax Regulations provides that, as to any property, or part thereof or interest therein, of which the donor has so parted with dominion and control as to leave in him no power to change its disposition, whether for his own benefit or for the benefit of another, the gift is complete. But if upon a transfer of property (whether in trust or otherwise) the donor reserves any power over its disposition, the gift may be wholly incomplete, or may be partially complete and partially incomplete, depending upon all the facts in the particular case. Accordingly, in every case of a transfer of property subject to a reserved power, the terms of the power must be examined and its scope determined.

Rev. Rul. 64-328, 1964-2 C.B. 11, considers a split-dollar life insurance arrangement, in which the employer pays the portion of the premiums equal to the increases in the cash surrender value and the employee pays the balance, if any, of the premiums. From the proceeds payable upon the employee's death, the employer receives an amount equal to the greater of the cash surrender value or at least an amount equal to the funds it has provided, with the beneficiary receiving the balance. The ruling holds that the employee must include in income annually the annual value of the benefit the employee receives under the arrangement, which is an amount equal to the 1-year term cost of the declining life insurance protection to which the employee is entitled from year to year, less the portion, if any, the employee provides. Rev. Rul. 64-328 also provides that the cost of life insurance protection as shown in the table contained in Rev. Rul. 55-747, 1955-2 C.B. 228 (P.S. 58 Rates) may be used to compute the value of the one-year term life insurance protection provided to the employee. The ruling further states that the same income tax result follows if the transaction is cast in some other form that results in a similar benefit to the employee.

Rev. Rul. 66-110, 1966-1 C.B. 12, amplified Rev. Rul. 64-328, and held that the insurer's published premium rates for one-year term insurance may be used to measure the value of the current life insurance protection if those rates are available to all standard risks and are lower than the P.S. 58 rates. Rev. Rul. 67-154, 1967-1 C.B. 11, amplified Rev. Rul. 66-110 by holding that an insurer's published term rates must be available for initial issue insurance (as distinguished from rates for dividend options) in order to be substituted for the P.S. 58 rates set forth in Rev. Rul. 55-747.

Notice 2001-10, 2001-1 C.B. 459, revoked Rev. Rul. 55-747 and provided in Table 2001 an interim substitute for the P.S. 58 rates that taxpayers may rely upon pending further guidance. Taxpayers, however, may use the P.S. 58 rates for taxable years ending on or before December 31, 2001.

Notice 2002-8, 2002-1 C.B. 398, revoked Notice 2001-10. Notice 2002-8 provides that in the case of split-dollar life insurance arrangements entered into before the effective date of future guidance, taxpayers can use the premium rates in Table 2001 to determine the value of current life insurance protection on a single life that is provided under a split-dollar life insurance arrangement. In addition, Notice 2002-8 describes circumstances in which taxpayers may continue to use the P.S. 58 rates.

Notice 2002-8, Part III.3, provides that for arrangements entered into before the effective date of future guidance (and before January 29, 2002), taxpayers may, to the extent provided by Rev. Rul. 66-110, as amplified by Rev. Rul. 67-154, continue to determine the value of current life insurance protection by using the insurer's lower published premium rates that are available to all standard risks for initial issue one-year term insurance.

Notice 2002-8, Part IV.2, provides that for split-dollar life insurance arrangements entered into before the date of publication of final regulations, in cases where the value of current life insurance protection is treated as an economic benefit provided by a sponsor to a benefited person under a split-dollar life insurance arrangement, the Service will not treat the arrangement as having been terminated (and thus will not assert that there has been a transfer of property to the benefited person by reason of termination of the arrangement) for so long as the parties to the arrangement continue to treat and report the value of the life insurance protection as an economic benefit provided to the benefited person.

Final regulations regarding the income, employment and gift taxation of split-dollar life insurance arrangements were promulgated in T.D. 9092, 68 F.R. 54336 (September 17, 2003), 2003-2 C.B. 1055. These regulations apply to any split-dollar life insurance arrangement (as defined in the regulations) entered into after September 17, 2003. The regulations also provide that if an arrangement is entered into on or before September 17, 2003, and is materially modified after September 17, 2003, the

arrangement is treated as a new arrangement entered into on the date of the modification. Section 1.61-22(j) of the Income Tax Regulations.

Rev. Rul. 2003-105, 2003-2 C.B. 696, declared as obsolete certain revenue rulings, including Rev. Rul. 66-110 (except as provided in Part III.3 of Notice 2002-8), and Rev. Rul. 64-328. However, Rev. Rul. 2003-105 also provides that in the case of any split-dollar life insurance arrangement entered into on or before September 17, 2003, taxpayers may continue to rely on these revenue rulings to the extent described in Notice 2002-8, but only if the arrangement is not materially modified after September 17, 2003.

The taxation of the split-dollar life insurance arrangement between Trust and Partnership is not subject to § 1.61-22(d) through (g) and § 1.7872-15 because Agreement was entered into on or before September 17, 2003 and has not been materially modified after that date. Instead, the taxation of the arrangement is determined under prior law. See Rev. Rul. 2003-105.

In the present case, under the terms of the Agreement, Trust will pay the portion of the premium equal to the cost of current life insurance protection. Partnership will pay the balance of the premium, and Partnership will be entitled to receive an amount equal to the greater of premiums paid or cash surrender value at the death of A. We conclude that the payment of the premiums by Partnership under the terms of the Agreement, will not result in income to, or gifts by A, provided that the amounts paid by Trust for the life insurance benefit that Trust receives under the Agreement is at least equal to the amount prescribed under Rev. Rul. 64-328, Rev. Rul. 66-110, and Notice 2002-8. We also conclude that, if some or all of the cash surrender value is used (either directly, or indirectly through loans) to fund the Trust's obligation to pay premiums, Partnership (i.e., the partners) will be treated as making a gift at that time.

Ruling Request 2

Section 2042(1) provides that the value of a decedent's gross estate shall include the proceeds of insurance policies on the decedent's life receivable by the decedent's estate.

Section 2042(2) provides that the value of a decedent's gross estate shall include the proceeds of all life insurance policies on the decedent's life receivable by beneficiaries other than the executor of the decedent's estate, to the extent that the decedent possessed at his death any incidents of ownership exercisable either alone or in conjunction with any other person. An incident of ownership includes a reversionary interest arising by the express terms of the instrument or by operation of law only if the value of such reversionary interest exceeds 5 percent of the value of the policy immediately before the death of the decedent.

Section 2042-1(c)(2) of the Estate Tax Regulations provides that “incidents of ownership” is not limited in its meaning to ownership of a policy in the technical legal sense. Generally, the term has reference to the right of the insured or his estate to the economic benefits of the policy. Thus, it includes power to change the beneficiary, to surrender or cancel the policy, to assign the policy, to revoke an assignment, to pledge the policy for a loan, or to obtain from the insurer a loan against the surrender value of the policy.

In the present case, it is represented that A will dispose of his interest in General Partner A. Accordingly, we conclude that the proceeds of the policy payable to the Trust will not be included in the gross estate of A under section 2042(2).

Except as specifically set forth above, we express no opinion concerning the federal tax consequences of the foregoing transactions under any other provisions of the Code or regulations.

Under a power of attorney on file with this office, we are sending a copy of this letter to Trustee’s authorized representative.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,

George Masnik
Branch Chief, Branch 4,
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)
Copy of this letter
Copy for § 6110 purposes

cc: